IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. ~~947~~ 89

AUTOMOBILE CLUB OF MICHIGAN,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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Automobile Club of Michigan prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in this case on February 17, 1956.

OPINIONS BELOW

The opinion of the Tax Court of the United States, entered September 23, 1953, is reported in 20 T. C. 1033. The opinion of the Circuit Court of Appeals, printed in Appendix B hereto, *infra*, pp. 4a-34a, is reported in 230 Fed. (2d) 585.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 17, 1956, and is set forth in Appendix C, *infra*, p. 35a. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1).

QUESTIONS PRESENTED

Three separate questions are presented for review:

I. Membership Dues

Was the petitioner, reporting on the accrual basis, entitled to report prepaid membership dues as income when earned, rather than when received, in accordance with the method of accounting regularly employed by petitioner in keeping its books?

II. Retroactive Revocation of Tax Exempt Status

Did the Commissioner of Internal Revenue in 1945 have authority to revoke with retroactive effect the rulings previously made by a predecessor Commissioner which held that petitioner was exempt from taxation, when there had been no change in the law or in the character and operation of the petitioner as a club?

III. Statute of Limitations

If the Commissioner of Internal Revenue had the power to revoke retroactively petitioner's previously established tax exempt status, did the statute of limitations bar the assessment of the deficiencies asserted for the years 1943 and 1944?

STATUTES INVOLVED

The pertinent statutory provisions are printed in Appendix A, *infra*, pp. 1a-3a.

STATEMENT

The basis of the jurisdiction of the Court of first instance, the Tax Court of the United States, was a petition filed by the taxpayer pursuant to section 272 of the Internal Revenue Code of 1939, for a redetermination of deficiencies asserted by the Commissioner of Internal Revenue for the calendar years 1943, 1944, 1945, 1946 and 1947.

The facts are not in dispute. The case with respect to each of the three questions is as follows:

Question I. Membership Dues

Petitioner, an automobile club rendering various services to its members, kept its books on a calendar year basis and upon the accrual method of accounting. Its chief source of revenue was from membership dues, which were received by petitioner in every month of the year. A member paid his dues, not for past services rendered, but for services to be rendered to him by petitioner during the 12-month period following the payment of the dues.

Under petitioner's accrual method of accounting, the dues received from a member were recorded in an account designated as "Unearned Dues". Each month, as the dues were earned, petitioner transferred one-twelfth of the member's dues from the "Unearned Dues" account to an account designated on its books as "Membership Income".

Thus, if a member paid his dues in December, 1945, petitioner's books recorded only one-twelfth of the dues as income for 1945, and eleven-twelfths of the dues were recorded as income for the year 1946. If a member resigned the unearned portion of his dues was refunded to him. The petitioner consistently followed this method of accounting which was adopted—many years before the revocation of petitioner's tax exempt status—upon the recommendation of its accountants as best reflecting its income.

Petitioner filed its income tax returns in accordance with its books, and included as income each year from dues the amounts credited to the "Membership Income" account. The Tax Court sustained the Commissioner's contention that under the "claim of right" doctrine the dues were income for tax purposes when received, rather than when earned. The Circuit Court of Appeals affirmed. It is petitioner's contention that the "claim of right" doctrine is inapplicable, and that it correctly reported the income from dues as earned in accordance with the method of accounting regularly employed in keeping its books.

Question II. Retroactive Revocation of Tax Exempt Status

Petitioner, incorporated under the laws of Michigan, was organized and has always operated as a non-profit organization. It has no capital stock and cannot pay dividends on earnings to its members, even in the event of its dissolution. On June 11, 1934, the Commissioner of Internal Revenue by a letter to petitioner ruled that petitioner was exempt from taxation under the provisions of section 103(9) of the Internal Revenue Act of 1932 and corresponding provisions of prior Revenue Acts. The ruling letter advised petitioner:

> "You are not, therefore, required to file returns for 1933 and prior years and it follows that future

> returns, under the provisions of section 101(9) of the Internal Revenue Act of 1934, will not be required so long as there is no change in your organization, your purpose or method of doing business."

It is conceded that the above ruling was based upon a complete disclosure by petitioner of the purpose for which it was organized and the manner in which it operated.

In 1938 the Commissioner of Internal Revenue again requested petitioner to submit data as to its right to exemption from tax. Upon receipt of all information requested of the petitioner, the Commissioner ruled, in a letter dated July 5, 1938, that petitioner was exempt from taxation under the Revenue Act of 1936, and specifically confirmed the previous ruling holding the petitioner to be exempt from filing income tax returns.

In 1945 a new Commissioner of Internal Revenue advised petitioner that the Bureau of Internal Revenue was reconsidering the exemption of automobile clubs, and requested petitioner to furnish data as to its purposes and manner of operation. After receipt of that information the Commissioner of Internal Revenue notified petitioner by a letter dated July 16, 1945 that petitioner was not exempt from taxation under section 101(9) of the Internal Revenue Code of 1939 or the corresponding provisions of prior Revenue Acts, and the Commissioner revoked the previous rulings given in 1934 and 1938. The Commissioner requested petitioner to file tax returns for 1943 and subsequent years.

The retroactive revocation in 1945 of the rulings received by petitioner in 1934 and 1938 was not based on any intervening change in the statute or in the manner in which petitioner conducted its activities, or on any misrepresen-

tation, concealment, or fraud on the part of the petitioner. The revocation was based on the lack of social activities between the members of the club. The prior Commissioner was aware of this lack of social activities when he issued tax exempt rulings to petitioner in 1934 and 1938.

Before the Tax Court, petitioner conceded that the Commissioner in 1945 could revoke with prospective effect the rulings previously given to taxpayer, but contended that the Commissioner was without authority to revoke those rulings with retroactive effect. The Tax Court held that the retroactive revocation was valid, and the Circuit Court of Appeals affirmed. In a dissenting opinion, Circuit Judge McAllister stated that the Commissioner in 1945 could not revoke the former rulings with retroactive effect. It is petitioner's contention that the dissenting opinion correctly states the law.

III. Statute of Limitations

The petitioner did not file income tax returns on the due dates for the years 1943 and 1944, in reliance upon the regulations and the two prior rulings of the Commissioner of Internal Revenue which advised the petitioner that having established its tax exempt status it was not required to file income tax returns. Returns for those years were filed under protest after the Commissioner in 1945 revoked petitioner's exempt status, and on the returns petitioner claimed its exemption from tax.

However, petitioner filed, for the calendar years 1943 and 1944, the annual information return (Form 990) required of certain tax exempt organizations under section 54(f) of the Internal Revenue Code of 1939. Petitioner's return on Form 990 for the calendar year 1943 was filed on August 12, 1944, and the return for the calendar year

1944 was filed on May 17, 1945. Attached to each of the returns was a statement of petitioner's gross income and receipts for the year, its disbursements, and a statement of its assets and liabilities. All the data and information requested of the petitioner was furnished the Commissioner.

Before the Tax Court, petitioner contended that the 3-year statute of limitations for the assessment of deficiencies commenced to run on the due dates for filing the returns for 1943 and 1944, since the Government itself induced and caused the petitioner not to file tax returns on the due dates. It is conceded that if the statute of limitations started to run on the due dates for the returns, the statute bars the assessment of any deficiency for the years 1943 and 1944.

Petitioner also contended before the Tax Court that the filing of the annual return on Form 990 commenced the running of the statute of limitations so as to bar the assessment of any deficiency for 1943 and 1944. The Tax Court held that the statute of limitations did not bar the assessment of deficiencies, and the Circuit Court of Appeals affirmed.

If Question II is resolved by a decision that the Commissioner's retroactive revocation of petitioner's tax exempt status was invalid, then Question III as to the statute of limitations becomes moot.

REASONS FOR GRANTING THE WRIT

I. On the question whether membership dues constituted income to petitioner when received or when earned:

A. There is a direct conflict among Circuits.

The decision of the Court of Appeals on the membership dues issue is in direct conflict with the decision of the Court of Appeals for the Tenth Circuit in *Beacon Publishing Company v. Commissioner*, (1955) 218 Fed. (2d) 697, and with the decision of the Court of Appeals for the Fifth Circuit in *Schuessler et al. v. Commisisoner*, (March 4, 1956), which has not yet been printed in the official reports. The opinion of the Tenth Circuit is printed in Appendix D, *infra* pp. 36a-43a, and the opinion of the Fifth Circuit in the *Schuessler* case is printed in Appendix D, *infra*, pp. 44a-48a.

In the *Beacon Publishing Company* case, the single question presented was whether prepaid newspaper subscriptions should be included in the taxpayer's income for the year in which they were received, or be spread over the subscription period. The publishing company kept its books and filed its income tax returns on the accrual basis of accounting and prepaid subscriptions were credited to a liability account entitled "Prepaid Subscriptions" and included in income only as the subscriptions were earned. It was conceded that the taxpayer received the prepaid subscriptions without restrictions as to their use.

The Commissioner claimed the prepaid subscriptions were income for the year in which received, just as he contends in petitioner's case that prepaid membership dues were income when received. The Tax Court, in sustaining

the Commissioner in *Beacon Publishing Company* (1954) 21 T. C. 610, cited its decision in petitioner's case (*Automobile Club of Michigan,* 20 T. C. 1033) as a precedent for taxing prepaid income for the year when received.

The Tenth Circuit Court of Appeals reversed and held that prepaid income received by an accrual basis taxpayer constitutes income only as the expenses of earning that income are incurred. The Tenth Circuit Court of Appeals pointed out that the "claim of right" doctrine, relied upon by the Commissioner and the Tax Court, as enunciated by this Court in such cases as *North American Oil Consolidated v. Burnet,* 286 U. S. 417; *United States v. Lewis,* 340 U. S. 590, and *Healy v. Commissioner,* 345 U. S. 278, has no application to such a case of prepaid income. The "claim of right" cases previously presented to this Court have not involved a case like *Beacon Publishing Company,* or like petitioner's case, where prepaid income is received in one year, without any dispute as to the ownership of the funds, and the expenses of earning that income are incurred in a subsequent year.

In its brief to the Court below, petitioner vigorously, but unsuccessfully, urged the Court to follow the decision of the Tenth Circuit Court of Appeals in the *Beacon* case as to the tax treatment of prepaid income.

After the decision in petitioner's case was rendered by the Court below, the Fifth Circuit Court of Appeals decided the case of *Schuessler et al. v. Commissioner* (printed in Appendix D, *infra,* pp. 44a-48a). This decision adopts and follows the decision of the Tenth Circuit Court of Appeals in the *Beacon* case and is likewise in direct conflict with the decision below in petitioner's case.

In the *Schuessler* case the taxpayer sold gas furnaces with a guarantee that he would turn the furnaces on and

off each year for five years. He kept his books on the accrual method and as furnaces were sold he set up a reserve, which he deducted on his income tax returns, to cover the cost of the service over the five-year period. The Tax Court (*E. W. Schuessler*, 24 T. C. ..., No. 28) disallowed the deduction and stated:

> "This is essentially the same problem as the reporting of prepaid income in the year in which received for services to be performed in following years. The petitioner in fact, on brief, recognizes that the two problems are identical and cites *Beacon Publishing Company v. Commissioner*, 218 Fed. (2d) 697 (C. A. 10, 1955), in support of his argument that the reserve here in issue was a proper deduction in computing his income for 1946."

The Tax Court simply declined to follow the decision of the Tenth Circuit Court of Appeals in the *Beacon* case. The Fifth Circuit, in reversing the Tax Court, stated:

> "We prefer the reasoning as well as the conclusion reached by the Court [in the *Beacon* case] in the Tenth Circuit. There the opinion correctly, we think, disposed of the 'claim of right' theory advanced by the Commissioner and adopted by the Tax Court in this type of case."

In its opinion, the Fifth Circuit Court of Appeals also relied on the decision of the Ninth Circuit Court of Appeals in *Pacific Grape Products Co. v. Commissioner* (1955) 219 Fed. (2d) 862. In that case the taxpayer, engaged in the fruit canning business, kept its books on the accrual basis and reported income from sales in the year it billed its buyers and took as a deduction the estimated cost of labeling and preparing the goods for shipment and brokerage fees to be paid the following years. The Tax Court dis-

allowed the deduction for the estimated expenses, but the Court of Appeals reversed, saying:

> "Not only do we have here a system of accounting which for years has been adopted and carried into effect by substantially all members of a large industry, but the system is one which appeals to us as so much in line with plain common sense that we are at a loss to understand what could have prompted the Commissioner to disapprove it. Contrary to his suggestion that petitioner's method did not reflect its true income it seems to us that the alterations demanded by the Commissioner would wholly distort that income."

The decisions in the *Beacon, Schuessler,* and *Pacific Grape Products* cases apply and follow the provisions of sections 41 and 42 of the Internal Revenue Code of 1939 (Appendix A, *infra,* p. 1a) which provide that net income shall be computed in accordance with the method of accounting regularly employed by the taxpayer in keeping his books so long as that method clearly reflects income. The decision of the Court below in petitioner's case simply ignores the statutory provisions.

It is beyond dispute that petitioner's method of reporting its income from prepaid membership dues would have been sustained if its case had been decided by the Court of Appeals for either the Fifth, Ninth, or Tenth Circuits. A situation therefore has resulted whereby taxpayers in the Fifth, Ninth and Tenth Circuits must be treated differently by the Commissioner than taxpayers in the Sixth Circuit with similar problems. For the Commissioner to be able to thus discriminate is obviously unfair and certainly most detrimental to the equitable and proper enforcement of the revenue laws. A decision of this Court is needed to eliminate this discrimination and insure uniformity of the tax treatment of prepaid income.

B. An important question of Federal law is presented which has not been, but should be, settled by this Court.

Sections 452 and 462 of the Internal Revenue Code of 1954 were intended to settle for 1954 and subsequent years the controversies which have arisen over the tax treatment of prepaid income and taxpayers' reserves for estimated expenses. Section 452, dealing with prepaid income, specifically reached the same result which the Tenth Circuit Court of Appeals reached in the *Beacon Publishing Company* case, *supra*. Section 462 specifically allowed a deduction for a reserve for estimated expenses of the type involved in the *Schuessler* and *Pacific Grape Products* cases, *supra*.

In 1955 sections 452 and 462 of the Internal Revenue Code of 1954 were repealed (Public Law No. 74, 84th Cong. 1st Sess.). The Ways and Means Committee, in recommending the repeal, stated: (H. Rep. No. 293, 84th Cong. 1st Sess., p. 4):

> "Your committee in repealing sections 452 and 462 does not intend to disturb prior law as it affected permissible accrual accounting provisions for tax purposes, including the treatment of prepaid newspaper subscriptions."

The Secretary of the Treasury advised the Chairman of the Committee on Ways and Means as follows (H. Rep. 293, *supra*, p. 295):

> "Furthermore, the Treasury Department will not consider the repeal of section 452 as any indication of congressional intent as to the proper treatment of prepaid subscriptions and other items of prepaid income, either under prior law or under other provisions of the 1954 Code. In other words,

> the repeal of section 452 will not be considered by the Department as either the acceptance or the rejection by Congress of the decision in *Beacon Publishing Co. v. Commissioner*, (218 F. (2d) 697, C. A. 10, 1955) or any other judicial decisions."

It can also be noted that the Fifth Circuit Court of Appeals in its opinion in the *Schuessler* case, *supra*, stated that the enactment and the subsequent repeal of sections 452 and 462 of the Internal Revenue Code of 1954 were without significance in construing the provisions of the Internal Revenue Code of 1939.

The repeal of sections 452 and 462 merely aggravates the need for an early decision by this Court on the proper tax treatment of prepaid income. The Senate Finance Committee, in its report on Public Law No. 72 (Senate Report 372, 84th Cong. 1st Sess., p. 6) called attention to the confusion and uncertainty which exists as a result of lower court decisions dealing with estimated expenses and prepaid income. On page 5 of the Report, the Committee stated:

> "Uncertainty will also exist in other areas with the repeal of these two provisions. In *Pacific Grape Products* (C. C. A. 9th, February 10, 1955), for example, the circuit court held that certain freight and shipping expenses incurred after the end of the year could be accrued for tax purposes as of the end of the year. An extension of the principles laid down in this case might well lead the courts in the future to permit the accrual of most estimated expenses which would be covered by section 462 even though this section is repealed."

This statement of the Senate Finance Committee indicates it would welcome—if it has not invited—a decision by this Court settling the law on the tax treatment of prepaid

income and reserves for estimated expenses, a recurring and important income tax question on which the lower courts have been unable to reach agreement.

II. The second question—whether the Commissioner in 1945 had the power to revoke, with retroactive effect, the prior determinations of his predecessors that petitioner was exempt from tax—presents an important question in Federal tax law which has not been, but should be, settled by this Court.

The question presented is of recurring importance in the administration of the income tax laws. Since our income tax system rests to a great and unique extent on voluntary compliance by the taxpayer in the self-assessment of the tax, it is exceedingly important that the taxpayer understands that he will be dealt with fairly by the Government. If the taxpayer knows that the Government can and will violate basic rules of fairness in administrating the tax law, the continued success of the income tax system of voluntary self-assessment is placed in jeopardy. Certainly if the Courts inform the taxpayer that the Government need not turn square corners in dealing with him, it may be too much to expect the taxpayer to turn square corners when he deals with the Government.

There can be no doubt that the practice of the Commissioner in issuing rulings to taxpayers serves a very useful function in the proper administration of the tax laws—if taxpayers can rely on those rulings. See the article, "Taxpayers' Rulings" in *5 Tax Law Review* 105 (1950) by Mr. J. P. Wenchel, former Chief Counsel of the Bureau of Internal Revenue. The ruling process has become an important part in the administration of the tax laws. In the Annual Report of the Commissioner of Internal Revenue for the Fiscal Year ended June 30, 1955, (House Document

No. 246, 84th Cong. 2d Sess.) it is stated (page 42) that 51,060 tax rulings were issued to taxpayers in the fiscal year 1954 and 38,547 rulings were issued in the fiscal year 1955. But the success of the ruling process must be solidly based on the right of taxpayers to rely with impunity on rulings issued by the Commissioner, where the taxpayer has not been guilty of misrepresentation or fraud in the presentation of his case to the Commissioner.

There are very clear indications that the Internal Revenue Service is disturbed and concerned by the action taken in this case in the retroactive revocation of petitioner's tax exempt rulings. Shortly after the Tax Court decision was rendered, the Commissioner publicly announced in substance that he would not make a practice of doing to other taxpayers what he did to the Automobile Club of Michigan. In Revenue Ruling 54-164, 1954-1, C. B. 88, 91, the Commissioner stated:

> "* * * It is the general policy of the Internal Revenue Service to limit the revocation of a ruling with respect to an organization previously held to qualify under section 101 to a prospective application only, if the organization has acted in good faith in reliance upon the ruling issued to it and a retroactive revocation of such ruling would be to its detriment."

It is fair to infer that this ruling was a direct result of adverse criticism received by the Commissioner following the Tax Court's decision in this case. For example, in an article published in the March 1954 issue of the Journal of Accountancy (page 321), the author, a tax practitioner, expressed concern over the action taken by the Commissioner in the retroactive revocation of petitioner's tax exempt rulings, and stated:

> "* * * For years the Service has followed a strict policy of respecting its rulings, and Service

> officials are well aware that nothing would more disturb the course of wise administration than the retroactive reversal of rulings after taxpayers have acted in reliance upon them."

It is not enough for the Internal Revenue Service to announce that it has a general policy of not revoking rulings of tax exempt status with retroactive effect. This Court should decide the overriding question as to whether or not the Commissioner of Internal Revenue has the power to revoke prior rulings with retroactive effect if he chooses to do so.

This question has a special importance in the case of rulings as to tax exempt status. Without question the great bulk of rulings issued by the Commissioner arise on the basis of unsolicited requests by the taxpayer for a ruling. But the regulations of the Commissioner *require* a taxpayer claiming ~~a tax~~ exempt status to file an application for a ruling. Article 101-1 of Regulations 94, in force during 1938 when Petitioner received his second ruling as to tax exempt status, provided:

> "A corporation is not exempt merely because it is not organized and operated for profit. *In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit* with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the charter or articles of incorporation, the by-laws of the organization, and the latest financial statement,

showing the assets, liabilities, receipts, and disbursements of the organization. * * *

* * * * *

"The Collector, upon receipt of the affidavit and other papers, will forward them to the *Commissioner for decision as to whether the organization is exempt.*

"When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created." (Emphasis supplied.)

These regulations have remained substantially unchanged since 1938, although they were amended to require certain organizations to file annual information returns under section 54(f), added in 1943 to the Internal Revenue Code of 1939.

In making a ruling under these regulations as to the tax exempt status of an organization, the Commissioner is doing much more than advising the taxpayer as to the Commissioner's interpretation of a stautory provision. The Commissioner, in appraising and passing judgment upon the purposes and activities of the organization claiming exemption from tax, acts as an administrative tribunal and performs a function judicial in nature. A ruling letter stating that the organization is exempt from taxation is treated by the taxpayer as an adjudication, and not a mere opinion of the Commissioner.

Nevertheless, the Commissioner contends that he has the power to revoke retroactively any ruling of tax exempt status made under the provisions of the above regulation, and he cites section 3791(b) of the Internal Revenue Code of 1939 (Appendix A, *infra*, p. 3a) as an acknowledgment

by Congress of such power. This Court, however, held in *Helvering v. R. J. Reynolds Tobacco Co.*, (1939) 306 U. S. 110, that section 3791(b) is without significance in cases where the Commissioner does not have power to make a retroactive ruling. In the *Reynolds* case, this Court held invalid an attempt by the Commissioner to amend retroactively the regulations concerning the tax treatment of gains realized by a corporation on its sale of treasury stock.

The dissenting opinion of Circuit Judge McAllister (Appendix B, *infra*, pp. 15a-34a) carefully reviews the facts in petitioner's case and properly stresses the gross inequity of the retroactive revocation of petitioner's tax exempt status. After reviewing the applicable precedents, and stating that the principle applied by this Court in the *R. J. Reynolds* case, *supra*, is applicable, Judge McAllister concluded:

> "The Commissioner's retroactive revocation of Petitioner's tax exempt status is, in my opinion, invalid."

His opinion presents the strongest argument which petitioner can make in support of its contention that this Court should decide whether, in circumstances of the kind presented in petitioner's case, the Commissioner has the right to revoke with retroactive effect former rulings granted by his predecessor.

III. On the third question—the statute of limitations—the decision below is in apparent conflict with the decisions of two other Circuit Courts of Appeal, and the issue presents an important question of Federal tax law, which has not been, but should be, settled by this Court.

Under section 275(a) of the Internal Revenue Code of 1939 (Appendix A, *infra*, p. 2a) the three-year statute of limitations for assessment of income tax deficiencies commences to run *from the date the return is filed.* However,

two Circuit Courts of Appeals have held that where the Commissioner is to blame for the failure of the taxpayer to file a return when due, the three-year statute of limitations starts running from the *due date* for the return. *Balkan Nat. Ins. Co. v. Commissioner of Internal Revenue,* (C. C. A. 2, 1939) 101 F. (2d) 75, and *Stockstrom v. Commissioner of Internal Revenue,* (C. A. D. C., 1950) 190 F. (2) 283.

In the *Balkan Nat. Ins. Co.* case the Commissioner mailed a notice of deficiency in 1934 with respect to the income and profits tax liabilities for the year 1918. The taxpayer, a foreign corporation, had not filed a return for the year 1918, and the Commissioner relied upon the provision of the statute which stated that the amount of the tax may be assessed at any time in case of a failure to file a return. The taxpayer had not filed a return for 1918 for the reason that in January of 1919 all of the taxpayer's assets, including its books of account and records, were seized by the Alien Property Custodian. The taxpayer claimed that the statute of limitations commenced to run on the due date for the filing of its return for the year 1918, contending it was excused from filing a return by reason of the seizure by the Alien Property Custodian of its books and records. The Circuit Court of Appeals for the Second Circuit held that the statute of limitations started to run on March 15, 1919, under the circumstances of the case, for the following reasons (at page 78):

> "While literally there has been 'a failure to file a return,' that phrase as used in section 278(a) cannot reasonably be interpreted to include a failure caused by the Government itself through seizure of the taxpayer's records. The obvious purpose of this section was to give the revenue officials unlimited time to assess and collect taxes in cases where the necessary data for determining the

amount of the tax was lacking *because of the taxpayer's fault in failing to supply it in the form of a return.* * * * In *Stearns Co. v. United States,* 291 U. S. 54, 62, 54 S. Ct. 325, 78 L. Ed. 647, the Supreme Court approved the principle that 'A suit may not be built on an omission induced by him who sues.' There the principle was applied to prevent a taxpayer from relying on the statute of limitations. We believe it is equally applicable to prevent the United States from avoiding the statute."

In the case of *Stockstrom v. Commissioner of Internal Revenue, supra,* the taxpayer had made gifts in trust during the calendar year 1938, and, after consulting with the head of the Federal Estate and Gift Tax Section of the Office of the Bureau of Internal Revenue in St. Louis, did not file a gift tax return for that year for the reason that the Bureau officials advised him that no tax or return was due. Stockstrom had not been correctly advised by the Bureau officials as to the law—he had, in fact, made taxable gifts in 1938. In 1948 the Commissioner issued a 90-day letter with respect to the gift tax liability for the calendar year 1938, claiming that the statute of limitations had not run since no return had been filed. The United States Court of Appeals for the District of Columbia Circuit held that the statute of limitations commenced to run on the due date for the return for the year 1938, notwithstanding that the statute provided that upon a failure to file a return the tax may be assessed at any time. In this case the Court cited the decision of the Second Circuit in *Balkan Nat. Ins. Co., supra,* and said (at pages 288, 289):

"Stockstrom did not physically file a return for 1938, as we have seen. The question is, however, did he fail to file a return within the meaning of the limiting statute? Or, to put it another way,

may the Commissioner in the circumstances of this case rely upon the failure to physically file a return as destroying the period of limitation? * * * *It has already been made to appear that Stockstrom's failure to file a return for 1938 was due to the Commissioner's ruling,* made in 1938 and reaffirmed as late as 1941, *that none was required of him. The Commissioner therefore induced the omission* which he now relies upon as giving him unlimited time within which to assess a tax. * * * We conclude that Stockstrom's failure to file a return for 1938 was not the sort of failure contemplated by §1016 of the Internal Revenue Code. * * * It has been well said that the government should always be a gentlemen. Taxpayers expect, and are entitled to receive, ordinary fair play from tax officials. *We regard as unconscionable the Commissioner's claim of authority to assess a tax in 1948 because of Stockstrom's failure to file a return for 1938, when the Commissioner himself was responsible for that failure.*" (Emphasis supplied.)

Petitioner find itself in the same position as the taxpayer in the *Balkan Nat. Ins. Co.* case and the *Stockstrom* case. Petitioner did not file income and excess profits tax returns on the due dates for the years 1943 and 1944 for the reason that the Bureau had previously issued two rulings to the petitioner advising that it was exempt from taxation and need not file returns so long as the character and nature of its organization and operation remained unchanged. There had been no change which placed the petitioner under a duty to file returns. The failure to file returns on the due dates was induced by the Commissioner—petitioner was entirely blameless.

Of course, petitioner does not contend that the statute of limitations should run in a case where the taxpayer obtains a tax exempt ruling by misrepresenting or concealing the facts, or where the taxpayer carries on his activities

in a manner not contemplated by the ruling. In such a case, there should be no question but that the Commissioner would have the power to revoke his ruling with retroactive effect and the statute of limitations should not bar the assessment of deficiencies. This would be a case where the Commissioner could exercise his discretion under section 3791(b) as to the extent to which he wants to make the revocation retroactive.

In the circumstances of petitioner's case, it cannot be said there was a duty to file returns on March 15, 1944 and March 15, 1945, and the running of the statute of limitations under the section 275(a) of the Internal Revenue Code of 1939 should be computed from these dates. Petitioner's failure to file a return was not, as the above cases hold, a failure to file within the meaning of section 276(a) of the Internal Revenue Code.

Furthermore, petitioner filed for the years 1943 and 1944 the return on Form 990 required by section 54(f) of the Internal Revenue Code of 1939. On these returns the petitioner furnished all information as to its income and deductions requested by the Commissioner. In filing Form 990, the petitioner filed the only return it was required to file under the regulations and tax exempt rulings issued to it, and under such circumstances the filing of Forms 990 did constitute a return for the purpose of the statute of limitations under section 275(a) of the Internal Revenue Code of 1939.

On August 25, 1948, petitioner executed waivers extending the period of time for the assessment of the tax for the years 1943 and 1944, but these waivers were executed more than three years after the due date for the filing of tax returns for 1943 and 1944. and more than three years after the filing of the returns on Form 990. Under the provisions of section 276(b) (Appendix A, *infra,* p.

3a), filing a waiver after the expiration of the three year statute of limitations is without legal effect.

It is not clear from the opinion below whether the Court disagreed with the decision of the Second Circuit Court of Appeals in the *Balkan* case and with the decision of the Circuit Court of Appeals for the District of Columbia in the *Stockstrom* case, but it is clear that the Court below did not apply those decisions. In this connection, it can be noted that the Court below in its opinion on the question of prepaid income ignored, without comment, the decision of the Tenth Circuit Court of Appeals in the *Beacon Publishing Company* case, *supra*.

In the ordinary case, a ruling which the taxpayer receives from the Commissioner does not advise him to abstain from filing income tax returns. But when the Commissioner rules that an organization is exempt from tax, the ruling will advise the organization—as petitioner was advised—that it should not file income tax returns so long as there is no change in its purposes or method of doing business.

In seeking an answer to the question of whether the Commissioner has the power to revoke retroactively a tax exempt ruling, there is a very practical relationship between that question and the question as to the statute of limitations. If the answer is that the statute of limitations cannot run when a taxpayer fails to file a return in reliance on a tax exempt ruling, such an answer presents a special reason and need for holding that the Commissioner does not have the power to revoke retroactively. On the other hand, if the rule is that the Commissioner does have the power to revoke retroactively, it becomes imperative to find some protection for the taxpayer under the statute of limitations.

Under the opinion below, the statute of limitations would not bar the assessment of deficiencies against the petitioner for any of its taxable years, dating back to 1916. Certainly there must be some bounds to the extent to which the Commissioner can entrap a taxpayer by issuing a ruling of tax exempt status on which the taxpayer relies in good faith. If the Commissioner under the law has the right to revoke a ruling of tax exempt status with retroactive effect, every-day considerations of equity and fair play call for the application against the Commissioner of the rule of the *Balkan* and *Stockstrom* cases, *supra*—that the statute of limitations commences to run on the due date for the filing of the return for the taxable year.

The proper application of the statute of limitations in such a case presents an important question which this Court has not, but should, settle.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

STATUTES

Internal Revenue Code of 1939

"SEC. 41. GENERAL RULE.

"The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *"

"SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

"(a) General Rule. —The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *"

"SEC. 54. RECORDS AND SPECIAL RETURNS.

* * * * *

"(f) Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this

chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. * * *"

"Sec. 101. Exemptions From Tax on Corporations.

"The following organizations shall be exempt from taxation under this chapter—

* * * * *

"(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;"

"Sec. 275. Period of Limitation Upon Assessment and Collection.

"Except as provided in section 276—

"(a) General Rule.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period."

* * * * *

"(c) Omission from Gross Income.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed."

"Sec. 276 Same—Exceptions.

"(a) False Return or No Return.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a

proceeding in court for the collection of such tax may be begun without assessment, at any time.

"(b) Waiver.—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon."

"Sec. 3791. Rules and Regulations.

* * * * *

"(b) Retroactivity of Regulations or Rulings.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect."

APPENDIX B

OPINION BELOW

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Automobile Club of Michigan, Petitioner, v. Commissioner of Internal Revenue, Respondent.	No. 12,247. Appeal from the Tax Court of the United States.

Decided February 17, 1956.

Before ALLEN, MCALLISTER and STEWART, Circuit Judges.

ALLEN, Circuit Judge. This case arises on petition to review a decision of the Tax Court of the United States sustaining a determination of deficiencies for the calendar years 1943 to 1947, inclusive, in the aggregate amount of \$447,445.44, \$161,184.43 being income taxes and \$286,-261.01 being excess profits taxes. Petitioner was organized as a nonprofit corporation without capital stock or shares and has never paid dividends. The facts are not in dispute and the questions presented are questions of law. The purposes of petitioner stated in its Articles of Association are the following:

> To promote and foster the healthy growth of the automobile industry; to secure the adoption and enforcement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; to interest automobile owners and drivers in the principles of "Safety First," as applied to automobile traffic; to promote touring and to obtain and furnish touring information and the necessary sign boarding of public highways; and to cooperate in

any work or movement which may tend to benefit the automobile driver, user, owner, or manufacturer, and the automobile industry in general.

As found by the Tax Court:

During 1943 through 1947 the petitioner devoted most of its resources and efforts to the bettering of conditions for motorists and the promotion of proper laws relating to the use of the motor car, the promotion of travel and the use of the automobile for other modes of transportation. It engaged in the promotion of safety, the solution of traffic problems and the promotion of the formation of school boy patrols. It organized the school boy patrols in Michigan. To teachers in the schools it furnished textbooks dealing with the conduct and operation of school boy patrols. As a reward it annually took some of the patrol boys to Washington, D. C. Annually it conducted seminars in the University of Michigan to promote the education of school teachers in the state in driver training courses. Petitioner's safety and traffic and engineer departments made surveys throughout the State of Michigan at the request of various cities and communities and many of its proposals as to safety measures were adopted. Petitioner supplied to its members in Michigan and those affiliated with the American Automobile Association emergency road service. The petitioner published and furnished to each of its active members a magazine containing news about travel and news about laws as they pertain to the use of automobiles. Maps and other touring information with reference to road conditions were also provided, as was assistance to the American Automobile Association in its designation or appointment of proper places for tourists to be housed and fed. The petitioner secured reservations for its members when traveling abroad and arranged for the shipping of their cars abroad. Petitioner also promoted and furnished gratis to various communities proper directional and stop signs. In its services the

> petitioner attempted to do for the motorist in a collective way that which he was unable to do as an individual.
>
> The petitioner does not engage in or conduct any social activities.

Petitioner during 1934 had supplied the Commissioner with detailed information concerning its operations, its financial assets and liabilities, and its receipts and disbursements. On June 11, 1934, the Commissioner wrote petitioner that on the basis of evidence submitted petitioner was entitled to exemption under the provisions of Section 101 (9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts; that, therefore, it was not required to file returns for 1933 and prior years, and that under the provisions of Section 101 (9) of the Revenue Act of 1934 it would not be required to file returns so long as there was no change in its organization, its purposes or methods of doing business.

On July 5, 1938, after submission by petitioner of the information required concerning its claim for exemption under Section 101 (9) of the Revenue Act of 1936, the Commissioner wrote petitioner advising it that "since it appeared that there had been no change in its form of organization or activities which would affect its status, the previous ruling of the Bureau holding it to be exempt from filing returns of income was affirmed under the Revenue Act of 1936."

In May, 1945, the Commissioner wrote petitioner that the Bureau of Internal Revenue was reconsidering the question of the exemption of automobile associations from Federal income taxation in light of the opinion of the Chief Counsel of the Bureau of Internal Revenue as set forth in G. C. M. 23688, C. B. 1943, 283. After petitioner had furnished certain further information, the Commissioner again wrote petitioner on July 16, 1945, calling attention to the fact that Section 101 (9) of the Internal Revenue Code provides for the exemption of

"Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder."

The Commissioner's communication continued as follows:

"This office holds that the term 'club' as used in the above section of law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term 'club.'

"The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

"It is, accordingly, held that you are not a club 'organized and operated exclusively for pleasure, recreation and other nonprofitable purposes,' within the meaning of section 101 (9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore, there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

"Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

"In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to January 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years."

In compliance with this communication petitioner filed income and excess profits tax returns for the calendar years 1943 and 1944 under protest, on the ground that it was exempt from taxes, and filed a petition to review the

determination of the Commissioner. During the trial before the Tax Court petitioner admitted that it was taxable "for the period subsequent to July 16, 1945," but contended that the Commissioner acted arbitrarily and without authority in revoking previous rulings as to exemption, and in determining a deficiency in taxes for any period prior to July 16, 1945. In this court petitioner contends that the Commissioner in 1945 was estopped from retroactively revoking the prior determinations, made by a predecessor Commissioner, upon the ground that there had been no change in the law or in the character and operation of petitioner as a club.

The Commissioner ruled correctly in his determination of July 16, 1945, that petitioner was not exempt from tax under Section 101 (9), Internal Revenue Code. The statute plainly applies, as decided in G. M. C. 23688, not to any and all organizations in which no dividends are declared, but to "clubs," namely, to organizations in which members commingle in fellowship. Also this section of the statute applies, not to every kind of club, but to clubs organized and operated exclusively for pleasure, recreation and other nonprofitable purposes. Since petitioner performs commercial services for its members it is not the kind of organization defined in the statute. The right to exemption which arises under Section 101 (9), as it is created by statute, cannot be modified by the regulations. Since petitioner did not fall within the exemption provision it was at no time exempt from taxation, but was excused from taxation by a legal error of the Commissioner. The requirement that petitioner file returns for the years 1943 and 1944 was therefore valid and proper and, since petitioner was not required to file returns for a number of preceding years, it cannot be claimed that the ruling was arbitrary and oppressive.

As to the question of estoppel, petitioner does not assert that it has altered its position to its detriment in reliance on the former rulings of the Commissioner. In default of proof to that effect estoppel does not enter into the case.

Petitioner urges that *H. S. D. Company v. Kavanagh*, 191 Fed. (2d) 831 (C. A. 6), and *Woodworth v. Kales*, 26 Fed. (2d) 178 (C. A. 6), require reversal of the Tax Court's decision. In the *H. S. D. Company* case the District Court, which had upheld the Commissioner in changing a ruling as to the exemption from taxation of contributions to two employees' trusts, was reversed by this court. We held that the Commissioner under the facts of that case was bound by the previous rulings of his predecessor determining that contributions to the employees' trusts were exempt from taxation. The court pointed out that the reasons for the successor Commissioner's action involved no new facts and no mistake of law, but only different inferences from the same facts. We there cited with approval an opinion by Judge Raymond, *Boyne City Lumber Company v. Doyle*, D. C. Mich., 47 Fed. (2d) 772, which declared that it is "an insupportable principle to say that such a determination of value may be reopened by each succeeding Commissioner, or by the same Commissioner, because a review of the same facts results in a difference or change of opinion." In *Woodworth v. Kales, supra,* this court held that, where income tax was assessed under a ruling approved by the then Commissioner of Internal Revenue, a succeeding Commissioner was without authority, upon a re-examination of the same evidence to revoke such assessment and reassess an additional tax. The court concluded that there was no statutory authority for the right to reopen and reexamine the question of the 1913 fair value of the stock involved and "then, upon a re-examination of the same evidence, to reach a different result, flowing not from the discovery of any fraud or mistake, clerical or otherwise, in any fundamental fact or matter of law, but resulting only from a 'more matured judgment.'" These cases do not, however, support petitioner's contention. In the *Kales* case the court declared that the Commissioner's "mistake of law will often, or usually, justify a revision of his conclusion." In the *H. S. D. Company* case we pointed out that the facts involved "no mistake of law, but only different inferences from the same facts." The Commissioner ~~is not~~ bound by his own or his predecessor's

prior mistakes of law. *Chattanooga Automobile Club v. Commissioner of Internal Revenue,* 182 Fed. (2d) 551 (C. A. 6); *Austin Company v. Commissioner of Internal Revenue,* 35 Fed. (2d) 910 (C. A. 6); *Keystone Automobile Club v. Commissioner of Internal Revenue,* 181 Fed. (2d) 402 (C. A. 3); *Smyth v. California State Automobile Association,* 175 Fed. (2d) 752 (C. A. 9), certiorari denied 338 U. S. 905. Cf. *Langstaff v. Lucas,* 9 Fed. (2d) 691, affirmed per curiam 13 Fed. (2d) 1022 (C. A. 6), certiorari denied 273 U. S. 721.

That the ruling of July 16, 1945, corrected a mistake of law cannot be disputed. The principal question was the legal significance of the word "club" in Section 101 (9) of the Internal Revenue Code. Another legal question was, if petitioner was a club in which its members commingled in fellowship, whether the organization and operation were exclusively for pleasure, recreation, and other nonprofitable purposes. The earlier Commissioners by their erroneous construction of the statute had made mistakes of law which were subject to correction by the later Commissioner.

Petitioner also claims that, irrespective of the decisions in the *H. S. D. Company* and the *Kales* cases, *supra,* it is entitled to exempt status under the doctrine of *Helvering v. R. J. Reynolds Tobocco Company,* 306 U. S. 110. This is on the theory that the Treasury Regulations 111, Section 29.101-1, and previous corresponding Regulations provided in substance that when an organization has established its right to exemption it need not thereafter make a return of income or any further showing with respect to its status unless it changes the character of its operations or the purpose for which it was originally created. An amendment made to the Regulations later in 1944 contained substantially the same provision. Congress enacted a number of Internal Revenue statutes during this period to which the Treasury Regulations cited apply, but Congress did not alter or change the law so as to affect these Regulations. Petitioner therefore claims that the Regulations cited, under the authority of the *Reynolds* case, *supra,* constituted a rule of law which can-

not be changed by a subsequent determination of the Commissioner.

In the *Reynolds* case the Supreme Court ruled that the gain secured by a corporation in the sale of its own stock in 1929 should be governed by the regulation in force in 1929, rather than by an amendment adopted by the Treasury in 1934, which made sales by a corporation of shares of its own capital stock subject to tax under certain circumstances. The Supreme Court refused to permit retroactive application of the Treasury amendments of 1934.

The Tax Court differentiated the *Reynolds* case from the instant one upon the ground that the Regulations there involved provided that a corporation realizes no gain or loss from the sale of its own stock and hence were legislative in character, while the Regulations here involed, Section 29.101-1 of Regulation 111, were administrative only.

In addition to this valid distinction between the *Reynolds* case and that presented herein we think a cogent answer to petitioner's contention is that upon this branch of the case it proceeds from its false premise that it established the right to exemption in 1934-1936, long before July 16, 1945, when the Commissioner revoked his previous ruling. Petitioner never had that right. If it had actually established such a right, the Commissioner could not rightfully revoke it, yet petitioner does not contest the Commissioner's right of revocation. The fact that the Commissioner in his earlier rulings misinterpreted the statutory meaning of the term "club" and ignored the circumstance that the services rendered petitioner's members were purely commercial, does not demonstrate that petitioner established a right to exemption. It demonstrates that the Commissioner made a mistake of law which under the weight of authority he was entitled to correct. *Chattanooga Automobile Club v. Commissioner of Internal Revenue, supra; Keystone Automobile Club v. Commissioner of Internal Revenue, supra; Smyth v. California State Automobile Association, supra.*

The retroactive ruling of the Commissioner ordering that tax returns be filed for 1943 and 1944 was authorized

under Section 3791(b) of the 1939 Code. This section reads as follows:

> Retroactivity of regulations or rulings.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

This provision clearly vests the Secretary or the Commissioner acting with approval of the Secretary, with the discretionary power to prescribe the extent, "if any," to which the ruling of the Commissioner shall or shall not be retroactive. The phrase "if any," authorizes the Secretary or the Commissioner acting with the approval of the Secretary to withhold retroactivity for the entire period involved or for any part thereof. In the instant case, if the Commissioner's ruling of July 16, 1945, were given full retroactive effect, it would require return of income taxes between the years 1934 and 1945. The Committee Reports of the House of Representatives, in recommending enactment of the predecessor section of the 1934 Act, pointed out that "Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute, will normally have a universal application. * * *" (House Report No. 704, 73rd Congress, 2d Section, page 38). The report then goes on to state that the cases involving rulings with reference to past transactions which have been closed by taxpayers in reliance upon existing practice, in some cases will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only. This legislative history supports the above construction of Section 3791 (b).

Under the established principle that the greater power includes the less, this statute conferred authority upon the Treasury officials named to make the ruling of July 16, 1945, retroactive for only part of the period involved

and for only two of the thirteen years. We conclude that this action was in no way arbitrary. The taxpayer was not misled nor has it shown that any unusual hardship resulted from the Commissioner's action.

Petitioner next urges that the statute of limitations bars assessment of the deficiencies asserted, contending that the period of limitations commenced to run from March 15, 1944, and March 15, 1945, when the 1943 and 1944 returns were due. If this is true, the assessment is barred. Ordinarily the three-year statute of limitations begins to run from the date that the return is filed, which date was October 22, 1945. If this date controls, the assessment is not barred. Section 275 (a) I. R. C. Petitioner claims that it was under no duty to file a return and that in such case the three-year statute of limitations starts running from the date the return should have been filed if there had been a duty to file it. *Balkan National Insurance Company v. Commissioner of Internal Revenue*, 101 Fed. (2d) 75 (C. A. 2).

In this connection the chronology of the proceedings is important. The rulings of exemption were revoked on July 16, 1945. Petitioner was ordered to file 1943 and 1944 returns and these returns were filed October 22, 1945. The parties on August 25, 1948, executed consents that the income and excess profits taxes could be assessed on or before June 30, 1949, and on May 23, 1949, executed similar consents that the income and excess profits taxes could be assessed on or before June 30, 1950. The notice of deficiency was mailed to petitioner February 20, 1950.

Petitioner's assertion that his returns were due in March, 1944, and March, 1945, ignores the fact that Section 276 (a) provides that in the case "of a failure to file a return the tax may be assessed * * * at any time."

The Commissioner relies upon this statute and points out that petitioner failed to file the returns for 1943 and 1944 until three months after July 16, 1945. Petitioner answers that it was entirely blameless in its failure to file upon the due dates because its inaction was caused by the

Commissioner. But when on July 16, 1945, the Commissioner expressly required petitioner to file returns, petitioner was under an obligation to file them as ordered. The delay in filing for more than three months was not induced by the Commissioner. Moreover, petitioner voluntarily agreed twice to extension of time for the assessment of the tax. This was not induced by the Commissioner.

The returns made upon Form 990 did not constitute the returns contemplated by Section 275 (a), namely, return of income taxes. They were not appropriate for the computation or assessment of income or excess profits taxes. As held by the Tax Court, they did not contain the data necessary to enable the Commissioner to compute petitioner's liability. Two taxes were involved here, income and excess profits taxes for 1943 and 1944. The returns on Form 990 for each year were not the returns required of corporations under Section 52 (a) of the Internal Revenue Code. The contention that where two returns are required one return answers the purpose was dismissed by the Supreme Court of the United States as having no merit in *Commissioner of Internal Revenue v. Lane-Wells Co.*, 321 U. S. 219. We conclude that under this record the assessment was not barred by Section 275 (a).

The determination that membership dues received by petitioner should be included in the return of income for the year in which they were received was clearly correct, *E. H. Sheldon & Company v. Commissioner of Internal Revenue*, 214 Fed. (2d) 655, 656 (C. A. 6); *S. Loewenstein & Son v. Commissioner of Internal Revenue*, 222 Fed. (2d) 919 (C. A. 6); *Spencer White & Prentis, Inc. v. Commissioner of Internal Revenue*, 144 Fed. (2d) 45 (C. A. 2); certiorari denied 323 U. S. 780; *North American Oil Consolidated v. Burnet*, 286 U. S. 417, 424; *Security Flour Mills Company v. Commissioner of Internal Revenue*, 321 U. S. 281; *United States v. Lewis*, 340 U. S. 590. In this case the Supreme Court stated "The 'claim of right' interpretation of the tax laws has long been used

to give finality to that [the accounting] period, and is now deeply rooted in the federal tax system. * * * We see no reason why the Court should depart from this well-settled interpretation merely because it results in an advantage or disadvantage to a taxpayer."

In conclusion the Tax Court correctly decided the issue as to depreciation deductions. Petitioner relies upon two General Counsel Memoranda, Nos. 10857 and 27491, as requiring that a different formula for depreciation deduction be applied from that used by the Commissioner. These memoranda have no bearing here. They come into force only where a petitioner is shown at some time during its existence to have been an organization exempt from taxation. As previously shown, petitioner was at no time exempt.

The decision of the Tax Court is affirmed.

McAllister, Circuit Judge, dissenting. While cheerfully acknowledging the persuasiveness of the excellent opinion of Judge Allen, it appears to me that the decision of the Tax Court should be reversed for the reason that I consider the Commissioner's revocation of petitioner's tax-exempt status, with retroactive effect, to be inequitable. A summary of the facts may clarify the conclusion that I think should follow.

The record discloses that in May, 1934, the Commissioner of Internal Revenue, in reply to petitioner's written claim to exemption from federal income tax, requested evidence in support of its claim. This evidence was submitted in writing by petitioner and consisted of a detailed explanation of its activities, the sources from which its income was derived, the disposition it made of its income, and facts with respect to its capital stock, dividends, and all other relevant facts relating to its activities. It disclosed that its income came from dues paid by the members of the club and the sale of advertising in a monthly magazine published by it; that no dividends or interest were paid on capital stock, and that, in fact, the club had no capital stock. The evidence submitted to the Commis-

sioner further disclosed that the club charged no entrance or initiation fees and that its activities were composed of touring service, including logs, road maps, general touring information to members, and emergency road service, such as starting of members' disabled cars on the road, towing them to official club garages, changing tires, and such similar services. Moreover, the club disclosed that it was interested in safety activities and that several men were employed by the club for work in the public schools as well as work in cooperation with the various cities of the State of Michigan to promote safety and improve traffic conditions. In addition, the club cooperated in all work or improvement which might tend to benefit the automobile driver, user, owner, or manufacturer, and the automobile industry in general.

After considering this evidence, the Commissioner wrote the club on June 11, 1934, stating:

> "Reference is made to the evidence submitted by you in support of your claim to exemption from Federal income taxation. * * * It is held that you are entitled to exemption under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts. You are not, therefore, required to file returns for 1933 and prior years and it follows that future returns, under the provisions of section 101(9) of the Revenue Act of 1934, will not be required so long as there is no change in your organization, your purposes or methods of doing business."

More than three years later, on September 29, 1937, the Commissioner sent the club a questionnaire and requested it to supply certain information concerning its claim for exemption under Section 101(9) of the Revenue Act of 1936. The club filled in the questionnaire, signed it, and returned it to the Commissioner, with a letter dated October 27, 1937, together with a copy of its financial statement as of December 31, 1936. Thereafter, the Commissioner again determined that the club was tax-exempt

under the Revenue Act of 1936, as it had been under the Revenue Act of 1932 and all prior revenue acts, and so notified the club by a letter dated July 5, 1938, in which the Commissioner stated:

> "Reference is made to the questionnaire and supporting data submitted in response to the request of the Bureau for the purpose of determining whether the exemption from income taxation under the provisions which now appear in Section 101 of the income tax law, to which you have heretofore been held to be entitled, is equally applicable under the Revenue Act of 1936.
>
> "Careful consideration has been given to the evidence submitted and as it appears that there has been no change in your form of organization or activities which would affect your status the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed under the Revenue Act of 1936."

Seven years later, on May 12, 1945, a new Commissioner wrote the club, stating:

> "Reference is made to Bureau ruling of June 11, 1934, holding you entitled to exemption from Federal income tax under the provisions of section 103 (9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.
>
> "The Bureau is now reconsidering the question of the exemption of automobile associations from Federal income tax in the light of the opinion of the Chief Counsel of the Bureau of Internal Revenue in regard thereto. * * *"

The Commissioner's letter further requested the club to submit evidence similar to that which it had already submitted on several occasions.

The club, in reply to the request of the Commissioner, thereafter submitted the information requested, which was, in all important particulars, the same as that which it had repeatedly furnished during the prior eleven years.

Upon receipt of this information, the new Commissioner made a determination based upon the same facts, law, and regulations as were in effect during the prior determinations, to the effect that the tax-exempt determinations of the prior Commissioner were erroneous and, accordingly, retroactively revoked the club's tax-exempt status by letter of July 16, 1945, which stated:

> "Reference is made to the information submitted by you for use in determining your status for Federal income tax purposes in view of the opinion expressed [by the Chief Counsel of the Bureau of Internal Revenue].
>
> "Under date of June 11, 1934 you were held entitled to exemption from Federal income tax under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938 under the provisions of the Revenue Act of 1936.
>
> "The information recently submitted by you shows that your activities consist of providing travel information and service, rendering emergency road service, publishing the Motor News, locating automobile parts for members' cars to keep them in service, providing safety education in public and parochial schools, organizing and equipping school patrols and providing traffic surveys for Michigan cities in the interest of safety. Your income is derived from membership dues, interest on investments, and advertising in the Motor News. It is expended for rendering services to your members."

The above evidence which the Commissioner referred to as "the information recently submitted by you" was exactly the same evidence that had been submitted by the club eleven years before.

The above letter from the Commissioner continued:

"Section 101(9) of the Internal Revenue Code provides for the exemption of:

'Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.'

"Prior revenue acts carry similar provisions.

"This office holds that the term 'club' as used in the above section of the law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term 'club'.

"The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

"It is, accordingly, held that you are not a club 'organized and operated exclusively for pleasure, recreation and other nonprofitable purposes', within the meaning of section 101(9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore, there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

"Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

"In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to Janu-

ary 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years."

This ruling dated July 16, 1945, therefore, retroactively revoked the Club's tax-exempt status for the two prior years of 1943 and 1944.

The Commissioner's retroactive revocation of petitioner's tax-exempt status is, in my opinion, invalid.

In *Rock Island, A. & I. Railroad Co. v. United States,* 254 U. S. 141, 143, Mr. Justice Holmes made the often quoted statement that "Men must turn square corners when they deal with the Government"; but, subsequently, referring to this observation, Judge McDermott, of the Tenth Circuit, in *Howbert v. Penrose,* 38 F. 2d 577, 581, added that "the government ought to turn square corners when dealing with its citizens." That policy has, apparently, heretofore been followed by the Commissioner of Internal Revenue. Thus, in an article, "Taxpayer's Rulings" in 5 Tax Law Review, page 115 (1950), Mr. J. P. Wenchel, formerly Chief Counsel of the Bureau of Internal Revenue, stated that, with exceptions not here relevant, "the policy of not disturbing a ruling once it has been issued, is now strongly ingrained in the administrative practice of the Bureau. Rulings are not issued indiscriminately, hypothetically, or for a useless purpose, and once issued they can be acted upon with reliance. This policy of fair play, which has been the unvarying policy of the Bureau for a decade and more is so strong that even where a Supreme Court decision changes the Bureau's previous interpretation of the law, and such change operates to the benefit of the Government, the Bureau at times has not applied such changes retroactively to the detriment of taxpayers, including those who did not ask for a ruling. Much water has gone over the dam since the Couzens case [*James Couzens,* 11 B. T. A. 1040 (1928)]. Taxpayers may find it more difficult to procure Bureau rulings than in those days, but once obtained, they can rely upon the Bureau's sense of fairness, and proceed to carry out their transactions knowing that they will

not be traced with a later assessment contrary to what had been expected.'"[1]

The foregoing policy would seem to have been confirmed by a Revenue Ruling,[2] issued by the Commissioner, strangely enough, after his revocation of petitioner's tax-exempt status, and after the decision of the Tax Court in this case, in the following language: "It is the general policy of the Internal Revenue Service to limit the revocation of a ruling, with respect to an organization previously held to qualify under section 101 to a prospective application only, if the organization has acted in good faith in reliance upon the ruling issued to it and a retroactive revocation of such ruling would be to its detriment." This professed policy of the Commissioner of Internal Revenue of not revoking his ruling once it had been acted upon, is consonant with the view of this court, not merely as to proper policy to be pursued, but as to the governing law, which has, for many years, been repeatedly and consistently followed in the decision of cases coming before it.

In *Woodworth v. Kales,* 26 F. 2d 178 (C. C. A. 6), in an opinion written for the court by Judge Denison, it was held that a new Commissioner is without authority to revoke the determination of a former Commissioner and reassess an additional tax based upon what appears to him to be a better judgment of the matter, if there are no newly discovered facts, no fraud or mistake, clerical or otherwise, in any fundamental fact or matter of law. See also *Routzahn v. Brown,* 95 F. 2d 766, 771 (C. C. A. 6), and *H. S. D. Co. v. Kavanagh,* 191 F. 2d 831 (C. A. 6).

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[1] In the above article, the author defined the term "taxpayer's ruling," as used therein, "to denote a statement in writing, normally in letter form, by the Commissioner of Internal Revenue or a Deputy Commissioner, setting forth the position of the Bureau with respect to a specific tax problem or problems of a specific taxpayer or taxpayers. Revenue agents and other representatives of the Bureau often give oral advice to taxpayers, but taxpayers cannot rely with impunity upon such representations or statements."

[2] Revenue Ruling 54-164, 1954-1 C. B. 88, 91 (originally issued as I. R. Mimeograph No. 54-73, dated April 28, 1954.)

In *Boyne City Lumber Co. v. Doyle,* 47 F. 2d 772 (D. C. Mich.), Judge Raymond stated that it was "unsupportable" to say that a determination of the value of the taxpayer's property could be reopened by each succeeding Commissioner because a view of the same facts resulted in a change of opinion, and it was held that the right to reopen such a determination depended upon the presence of a fraud, misrepresentation, or gross error. Further, in *Penrose v. Skinner,* 298 F. 335 (D. C. Col.), the court assumed that no one could contend that a succeeding Commissioner could overrule or ignore the decisions of his predecessor unless the decisions were erroneous in law or were tainted with fraud. The reasons for these views have been variously stated in different adjudications.

Courts have uniformly held that when the executive department of the government is charged with the execution of a statute, places a reasonable construction upon it, and acts upon that construction for a number of years, changes in the construction of the statute are looked upon with disfavor, when parties who have contracted with the government on the faith of the old construction may be injured thereby. *United States v. Alabama Great Southern Railroad Co.,* 142 U. S. 615; *Jacobs v. Pritchard,* 223 U. S. 200; *Whitebird v. Eagle-Picher Lead Co.,* 28 F. 2d 200 (D. C. Okla.), affirmed 40 F. 2d 479 (C. C. A. 10).

"If the language [of the statute] seemed to us doubtful (as it does not), the practically contemporaneous construction by the Treasury Department in its regulations would require us to exclude expenses incident to the organization of a corporation and the sale of its capital stock as being within the fair meaning of 'ordinary and necessary expenses incurred in carrying on the business' of such corporation." *Simmons Co. v. Commissioner of Internal Revenue,* 33 F. 2d 75, 76 (C. C. A. 1).

"Agencies do not enjoy a ruthless discretion to ignore their pasts. Like legislatures they must guard against illegal retroactivity. Like judges they are limited by res

judicata and influenced by stare decisis."[3] See *National Labor Relations Board v. Guy F. Atkinson Co.,* 195 F. 2d 141, 150 (C. A. 9).

In this case, it is not claimed that the retroactive revocation was based upon any newly discovered facts, fraud, or mistake, clerical or otherwise, in any fundamental fact. The one ground upon which the Commissioner contends that the retroactive ruling was proper and valid is that the former determination of the prior Commissioner was based upon a mistake of law, and that the succeeding Commissioner merely corrected this mistake.

That the prior rulings of the other Commissioners were based on a mistake of law, and, consequently, that the rulings can be revoked with retroactive effect, is the keystone of the Commissioner's argument in this case.

While the foregoing may be said to constitute the general rule it is not every ruling based upon a mistake of law that may be afterward subject to so-called correction by the Commissioner, with retroactive effect. Where the construction of a statute by a former Commissioner has not been plainly erroneous, or in conflict with express statutory provisions, a succeeding Commissioner may not revoke the former ruling with retroactive effect.

"It is settled by many recent decisions of this court that a regulation by a department of government, addressed to and reasonably adapted to the enforcement of an act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict with *express* statutory provision." (Emphasis supplied.) *Maryland Casualty Co. v. United States,* 251 U. S. 342, 349.

A construction of a statute made by the body charged with its enforcement, which has long been followed in practical execution, and has been impliedly sanctioned by the re-

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[3] See article by Frank C. Newman, "Should Official Advice Be Reliable?" 53 Columbia Law Review, pages 374, 376.

enactment of the statute without alteration in the particulars construed, must, *when not plainly erroneous,* be treated as read into the statute. *New York, N. H. and H. R. Co. v. Interstate Commerce Commission,* 200 U. S. 361, 401.

"This presumption that the department charged with the execution of the law has properly interpreted it is strengthened in proportion to the length of time such construction has obtained without challenge by the lawmaking power, so that, where such executive construction has been long continued, a court has a right to presume that Congress is content therewith. This exhausts the full force and effect of such construction, and, while not binding upon a court, nevertheless a court will be slow to depart therefrom, unless the language of the statute itself absolutely requires it to do so." *Mayes v. Paul Jones & Co.,* 270 F. 121, 130 (C. C. A. 6).

Where a statutory provision is ambiguous, and the executive department which must apply and enforce it declares a construction (not in itself ambiguous) for administrative purposes, and thereafter Congress reenacts the provision without substantial change, the courts will accept that construction unless it be plainly erroneous. *Walker v. United States,* 83 F. 2d 103, 107 (C. C. A. 8).

Regulations promulgated by the Treasury Department relative to income taxes have the force and effect of law, when not in conflict with *express* statutory provisions. *Crocker v. Lucas,* 37 F. 2d 275 (C. C. A. 9).

The construction given to the statute in this case by the former Commissioners cannot be said to be plainly erroneous and in confliet with the express provisions of the statute. That construction had been followed for twenty-three years by the Treasury Department.[4] The prior Commis-

[4] Automobile clubs were granted tax immunity by O. D. 643, 3 Cum. Bull. 241 (1920). That ruling was followed by G. C. M. 2867, VII-1 Cum. Bull. 115 (1928); G. C. M. 3555, VII-1 Cum. Bull. 117 (1928).

sioners had repeatedly asked for and received information from the taxpayer club and other automobile clubs with respect to every detail of their organization, activity, and characteristics; and had repeatedly held them to be tax-exempt under the provisions of the statute in question. When, finally, the last Commissioner "reconsidered," as he said, the status of automobile clubs and assessed taxes on the ground that they were not within the statutory exemption because they were not a "social club" and that they were not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, the California State Automobile Association brought an action in the district court to recover overpayments of tax, and Judge Lemmon, now a member of the Court of Appeals of the Ninth Circuit, in a persuasive and comprehensive opinion in *California State Automobile Association v. Smyth*, 77 F. Supp. 131 (1948), held that the association was a club within the meaning of the statute, and that it was organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, thus sustaining the rulings of the prior Commissioners of Internal Revenue.

When the same question came before the Tax Court in *Chattanooga Automobile Club v. Commissioner*, 12 T. C. 967 (1949), although the majority of the court held that the club was not exempt from taxation, four of the judges, in two separate opinions, dissented on the ground that the organization was a club within the meaning of the statute, and that it was organized and operated for a nonprofitable purpose.

It is true that the judgment of the district court in the Smyth case, *supra* was reversed in *Smyth v. California State Automobile Association*, 175 F. 2d 752 (C. A. 9), in an able opinion written for the court by Chief Judge Denman, in which the statute was construed in the light of the doctrine of ejusdem generis, pursuant to which it was held that clubs "organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes," in the language of the statute, meant that the "other nonprofitable purposes" must be concerned with pleasure

and recreation. However, in a similar case, *Keystone Automobile Club v. Commissioner of Internal Revenue*, 181 F. 2d 402 (C. A. 3), Judge Goodrich speaking for the court, in arriving at the same conclusion as the Court of Appeals of the Ninth Circuit to the effect that the club was not exempt from tax, rested his view on different grounds and expressly declined to construe the statute according to the doctrine of ejusdem generis, saying: "We have been treated to a good sized dose of so-called canons of construction known as noscitur a sociis and ejusdem generis in connection with the argument. We find them just about as helpful in settling a specific case as those vials of distilled wisdom of the ages containing the phrases 'birds of a feather flock together' and 'a man is known by the company he keeps.' Throwing a vague phrase into law Latin does not make it any more useful in construing a statute." It may be noted that the opinion of the General Counsel of the Bureau of Internal Revenue, upon which the Commissioner revoked petitioner's tax-exempt status, was posited upon a construction of the statute according to the doctrine of noscitur a sociis.

The construction of the Act, in the opinion of Judge Goodrich, was based upon the fact that the statute set forth numerous types of organizations which were specifically exempted from taxation; and that the type represented by an automobile club was entirely different from those spoken of in the other paragraphs; that if the taxpayer automobile club's contention was right, Congress had thrown in a lot of unnecessary and confusing classifications in the other paragraphs of the section; and that it, therefore, appeared that Congress, in speaking of "clubs organized and operated exclusively for pleasure, recreation and other nonprofitable purposes," was talking "about one type of organization among individuals which was, on the whole, different from the types talked about in other paragraphs of this section." Judge Goodrich, however, pointed out that no attempt had been made to give retroactive effect to the ruling of the new Commissioner's revocation of the tax-exempt status of automobile clubs.

Both Judge Denman and Judge Goodrich, in the above cases, took notice of the place occupied by the automobile in the life of the country forty years ago and the evolution that had occurred since that time, with the suggestion that passenger cars in the early years were not used for commercial purposes, and that it may well have been that car owners in those days did club together for their common interests. At some time, this changed, and, as Judge Goodrich said, the Commissioner had the right to change his mind about the relative place of automobile owners in the scheme of things. It, therefore, may well have been the case, that automobile clubs at one time were, without question, exempt from tax, and properly held so by the Commissioner. If so, it would seem inequitable that when a succeeding Commissioner arrived at the conclusion that the situation had changed, he could revoke the tax exempt status he had determined upon for such clubs, with retroactive effect.

In *Chattanooga Automobile Club v. Commissioner of Internal Revenue,* 182 F. 2d 551, 554 (C. A. 6), Judge Martin, speaking for the court in affirming the action of the Tax Court in the Chattanooga case, *supra,* set forth the grounds for holding an automobile club not exempt from taxation in the following language:

"The petitioners contend that the words 'other nonprofitable purposes' should not be construed as the Commissioner of Internal Revenue construed them to mean nonprofitable purposes *similar* to purposes of pleasure and recreation. This argument overlooks the fact that preceding subsections of section 101 of the Internal Revenue Code specifically exempt nonprofit organizations operated for literary, educational, scientific, charitable, or religious purposes, chambers of commerce, business and civic leagues, and other specified eleemosynary institutions. Were the insistence of the petitioners accepted, many of these specific exemptions would be mere surplusage, inasmuch as they would fall within the sweep of the expression 'other nonprofitable purposes' contained in subsection

9. We think the words 'other nonprofitable purposes' carry in the context a plain connotation that the purposes must be construed as coming within the same classification as pleasure and recreation. The services rendered by each club were in part to automobiles used for business purposes and, therefore, not operated 'exclusively' for pleasure, recreation, and other similar purposes."

As far as the power of the Commissioner to change the construction of a statute *with prospective effect* goes, Judge Martin, in the Chattanooga case, *supra*, quoted from *Helvering v. Wilshire Oil Co.*, 308 U. S. 90, 100, wherein the Supreme Court said:

> "The oft-repeated statement that administrative construction receives legislative approval by reenactment of a statutory provision, without material change (*United States v. Dakota-Montana Oil Co.* [288 U. S. 459, 466, 53 S. Ct. 120, 77 L. Ed. 893]) . . . does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers."

All of the above serves only to show clearly in what different lights the judges of the Tax Court, the district Court, and the courts of appeals viewed the statute, even when they agreed in their conclusions, and that the interpretation and construction placed upon the statute during twenty-three years by succeeding Commissioners of Internal Revenue, who studied and examined all the various provisions of the Act, repeatedly, intently, and with specific application to the club in question, was a fair interpretation, and, certainly, not plainly erroneous or contrary to the express words of the statute. As such, it cannot be revoked by a succeeding Commissioner with retroactive effect.

It is conceivable, too, that the authorities cited by the government to sustain the changed view of the successor Commissioner, might have also sustained him if he had found it proper to construe the statute in the sense now contended for by the taxpayer. For administrative agencies designated by Congress as specialists in a particular field and advised by experts are, within a wide area, in a better position than a reviewing court to determine appropriate applications of statutes which they are directed to administer. *National Labor Relations Board v. Medo Photo Supply Corp.*, 135 F. 2d 279 (C. C. A. 2). "The construction given to a statute by those charged with the duty of executing it is always entitled to the most respectful consideration, and ought not to be overruled without cogent reasons. . . . The officers concerned are usually able men, and masters of the subject. Not infrequently they are the draftsmen of the laws they are afterwards called upon to interpret." *United States v. Moore*, 95 U. S. 760, 763.

What is the principle of law to be applied in such cases as the one before us? It is the rule that the doctrine of estoppel must be applied with great caution as against the government and ~~its~~ officials. Some courts have, however, applied general equitable principles to prevent inequitable governmental action, as in suits for refunds, and this doctrine has been denominated "quasi estoppel" by some authorities.

As to estoppel against the government, that principle is summed up in *Ritter v. United States*, 28 F. 2d 265 (C. C. A. 3):

> "It is true . . . that when the sovereign becomes an actor in a court of justice its rights must be determined upon those fixed principles of justice which govern between man and man in like situations. . . . The acts or omissions of the officers of the government, if they be authorized to bind the United States in a particular transaction, will work estoppel against the government, if the officers have acted within the scope of their authority."

In *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co. et al.*, 284 U. S. 370, it was held that where the Interstate Commerce Commission had, upon complaint and after hearing, declared what was the maximum reasonable rate to be charged by a carrier, it may not, at a later time, and upon the same or additional evidence as to the fact situation existing when its previous order was promulgated, subject a carrier which conformed thereto to the payment of reparation measured by what the Commission then held it should have decided in the earlier proceeding, by declaring its own prior finding as to reasonableness to be erroneous. In passing upon the case, the court said: "The Commission's error arose from a failure to recognize that when it prescribed a maximum reasonable rate for the future, it was performing a legislative function, and that when it was sitting to award reparation, it was sitting for a purpose judicial in its nature. In the second capacity, while not bound by the rule of *res judicata*, it was bound to recognize the validity of the rule of conduct prescribed by it and not to repeal its own enactment with retroactive effect. It could repeal the order as it affected future action, and substitute a new rule of conduct as often as occasion might require, but this was obviously the limit of its power, as of that of the legislature itself."

In *Stockstrom v. Commissioner of Internal Revenue*, 190 F. 2d 283 (C. A. D. C.), it appeared that the taxpayer did not file gift tax returns in 1938 on a transfer to a trust because, under the Commissioner's interpretation, such gifts were of present interests and entitled to a \$5,000 exemption. The omission to file was approved in 1941. However, in 1948, following a Supreme Court decision, the Commissioner decided that the transfers in 1938 were taxable, and he, therefore, assessed a deficiency. The case went off on the question of whether the statute of limitations barred the deficiency assessment. Obviously, if a return had been filed, the deficiency assessment would have been barred. The court held that the Commissioner lacked authority to make the assessment. The holding was put on the ground that one may not found a claim upon an omission which he

himself induced. In this regard, the court quoted from Mr. Justice Cardozo in *Stearns Co. v. United States,* 291 U. S. 54: "The applicable principle is fundamental and unquestioned. 'He who prevents a thing from being done may not avail himself of the non-performance which he has himself occasioned, for the law says to him, in effect: "This is your own act, and therefore you are not damnified."' . . . Sometimes the resulting disability has been characterized as an estoppel; sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon his own inequity or take advantage of his own wrong. . . . A suit may not be built on an omission induced by him who sues." The court in the Stockstrom case, *supra,* continued: "It has been well said that the government should always be a gentleman. Taxpayers expect, and are entitled to receive, ordinary fair play from tax officials. We regard as unconscionable the Commissioner's claim of authority to assess a tax in 1948 because of Stockstrom's failure to file a return for 1938, when the Commissioner himself was responsible for that failure." See also the scholarly and comprehensive opinion of Judge Mathes in *Smale & Robinson, Inc. v. United States,* 123 Supp. 457 (D. C. Cal.).

The taxpayer did not have notice, as claimed herein by the Commissioner, during 1943 and 1944, of the pending revocation of its exemption rulings. The Commissioner contends that it had such notice as a result of the opinion expressed in the General Counsel's Memorandum No. 23688, issued in 1943. That memorandum involved the American Automobile Association, which was an organization consisting of other incorporated clubs, and having rules against membership of any individuals. The memorandum held that the term, "club," contemplated individual members and not an association composed entirely of artificial members; and then, although it had no relation to the organization in question, the memorandum went on to say that even if there were individual members, the organ-

izations would not qualify as clubs because there was not a commingling of members in fellowship. Such opinion of the General Counsel, issued in the case of a club composed of a number of corporate clubs, was not notice to petitioner herein of revocation of its tax-exempt status as of the time that the opinion was issued. As a matter of fact, in the Commissioner's letter to the club in 1945, he did not even then notify it of the revocation of its exemption from tax, and had not, at that time, decided to do so. The Commissioner's letter merely informed the taxpayer that the Bureau was reconsidering the question of exemption "in the light of the opinion of the Chief Counsel," and asked for the filing of a questionnaire—consisting of the same information the Commissioner already had in his files from this taxpayer. It is difficult to see how it could be maintained that the taxpayer had notice of the pending revocation of its tax-exempt status in 1943 as a result of the issuance of the Chief Counsel's opinion, when in 1945, the Commissioner first notified the taxpayer that he was only proceeding to take the matter under advisement and to reconsider, at that time, the tax-exempt status of the club. Petitioner had established its own tax-exempt status in accordance with Article 101-1 of Regulation 94,[5] in force during 1938, submitting to the Commissioner the information

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[5] "Art. 101-1. PROOF OF EXEMPTION.—A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the charter or articles of incorporation, the by-laws of the organization, and the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the organization. . . ." See also Section 29.101-1 of Treasury Regulation 111, promulgated under the Internal Revenue Code of 1939, as amended by T. D. 5381, 1944 Cum. Bull. 188, 189, and Section 29.101-2, as added by T. D. 5381, supra.

required by such regulation. Substantially the same provisions were contained in the regulations in force during 1934 when petitioner first submitted information to the Commissioner in obtaining the first ruling that it was exempt from taxation.

As to Section 3791(b) of the Internal Revenue Code, it would not seem to apply when the Commissioner does not have the power to make a retroactive ruling; and it could hardly be contended that the Commissioner, in such a case as the one before us, had the power to revoke, with retroactive effect, a tax-exempt status theretofore acquired for any period he considered proper, whether for two years or twenty years. Congress had repeatedly, over a period of a quarter of a century, reenacted Section 101(9) of the Internal Revenue Code, subsequent to the determinations of the various Commissioners that automobile clubs, and petitioner club in particular, were tax-exempt. The Treasury's power to make retroactive amendments, changing Treasury regulations or decisions, may not be exercised where Congress has, by repeated re-enactments, given its sanction to the existing regulations. *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110. See Studies in Federal Taxation, Randolph E. Paul, Third Series, pages 420, et seq., Harvard University Press, 1940. The same principle is here applicable, and a succeeding Commissioner may not retroactively revoke the several prior determinations of his predecessors that petitioner is tax-exempt where Congress has by repeated re-enactments of the pertinent provision of the statute, given its sanction to such prior determinations. As to the showing of hardship suffered by petitioner through retroactive revocation of its exemption from taxation, the fact that no reserves had been set up for such comparatively large tax for a two-year period, would seem to establish the prejudice that would be suffered by petitioner to its substantial injury, and if the Commissioner had the right, as he claims, to revoke retroactively petitioner's tax exemption for a possible thirteen-year period, it might well result in complete insolvency of the taxpayer.

Petitioner relied in good faith on the rulings made by the Commissioner in 1934 and 1938 holding it exempt from taxation. In keeping with the instructions received in the ruling letters, petitioner did not file income tax returns, since no change had occurred in the organization of the club, its purposes, or activities; and in reliance upon the tax-exempt rulings, it did not, during 1943 and 1944, set up any reserve or make any other provision to cover the income and excess profits taxes later asserted by the Commissioner for those years. Petitioning club was operated, during 1943 and 1944, in all respects on the premise that it was exempt from taxation. As a result of the retroactive application of his 1945 ruling, the Commissioner asserted a deficiency in income and excess profits taxes for the years 1943 and 1944 in the amount of $384,059.97.

Under the circumstances above set forth, it seems to me that it would be most inequitable to subject petitioner to payment of the deficiency claimed in this case as a result of the retroactive revocation of its exemption from taxation—covering a period of a quarter of a century and resulting from repeated rulings of the Commissioners of Internal Revenue in that period. In my opinion, the decision of the Tax Court should be reversed.

APPENDIX C

JUDGMENT BELOW

UNITED STATES CIRCUIT COURT OF APPEALS
For the Sixth Circuit

Automobile Club of Michigan,
Petitioner,
v.
Commissioner of Internal Revenue,
Respondent.

No. 12,247

Before Allen, McAllister and Stewart, Circuit Judges.

On Petition to Review a decision of the Tax Court of the United States.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

On Consideration Whereof, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby affirmed.

Approved for entry.

/s/ Florence E. Allen,
United States Circuit Judge.

Filed February 17, 1956.
Carl W. Reuss, Clerk.

APPENDIX D

CONFLICTING OPINIONS

Beacon Publishing Company, a Kansas Corporation, v. Commissioner

(U. S. Court of Appeals, Tenth Circuit, No. 4920, Jan. 1, 1955)

On Petition to Review the Decision of the Tax Court of the United States.

Before Bratton, Murrah, Pickett, Circuit Judges.

Pickett, Circuit Judge:

The single question presented by this petition to review a decision of the tax court is whether sums received for prepaid newspaper subscriptions should have been included in the taxpayer's income for the year in which they were received, or spread over the unexpired subscription periods.

The material facts are not in dispute. The taxpayer kept its books and filed its income tax returns on the accrual basis. It published a daily newspaper in Wichita, Kansas. The present stockholders acquired their stock in 1928 under the terms of an agreement which limited the taxpayer's bills and accounts payable to $100,000, unless consented to in writing by the seller. Prior to 1943, it maintained on its books an account entitled "Country Circulation" in which credits were carried for country agents' receipts and prepaid subscriptions. No separate account was kept for prepaid subscriptions. The prepaid subscription income included in this account was not treated as a liability and was considered as income for the year in which it was received. Beginning in 1942, the taxpayer carried on an intensive campaign to secure prepaid subscriptions for the purpose of obtaining additional working capital without violating the $100,000 debt limitation agreement.

The prepaid subscriptions were from thirty days to five years. The money received was not segregated and was used as working capital.

In 1943, the taxpayer employed an accounting firm to prepare a statement from its books of account. Without the consent of the Commissioner, this firm made a number of adjusting entries as of the close of 1943, one of which was to defer $95,686.92 by credit to an account entitled "Prepaid Subscriptions". For the years 1943 and 1944, the income received from the prepaid subscriptions was credited to the account as a liability, and the amount thereof deferred as subscription income. No attempt was made to allocate costs to this account or to show the cost of obtaining the prepaid subscriptions. It is conceded that the taxpayer received the prepaid payments without any restriction as to their use. In fact, they were obtained for use by the taxpayer. They were received and treated by the taxpayer as belonging to it. The Commissioner disallowed the deferment and included the full amount thereof in the income for the year in which it was received, thereby increasing the tax liability for that year. On redetermination, the Tax Court sustained the action of the Commissioner. 21 T. C. 610.

Under Section 41 of the 1939 Internal Revenue Code the net income of a taxpayer must be computed upon the basis of the taxpayer's annual accounting period in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. If this method does not clearly reflect the income, the computation shall be made by the Commissioner in accordance with such method as will clearly reflect the income. Section 42 provides that the amount of all gross income shall be included for the taxable year in which it was received unless "under methods of accounting permitted under Section 41, any such amounts are properly accounted for as of a different period." The obvious purpose of these provisions is to obtain from the taxpayer a return reflecting its true income and to treat income received and deductible disbursements consistently. United States v. Mitchell, 271 U. S. 9, 12.

Generally, the two methods of accounting used to determine income are the accrual and the cash receipts and disbursements methods. We are here concerned with the accrual method. Where a taxpayer keeps his books and files his returns on an accrual basis, income is accounted for in the year in which the amount is earned or becomes fixed, irrespective of when the payment is ultimately received. "It is the right to receive and not the actual receipt of income that determines when income must be included in gross income for income tax purposes. When the right to receive income becomes fixed and absolute, the duty of one on the accrual basis to report it arises." United States v. Harmon, 10 Cir., 205 F. 2d 919. See also Clark v. Woodward Construction Co., 10 Cir. 179 F. 2d 176. It is quite clear that under the accrual method of accounting it is the accrual of income and not its actual receipt that determines when it is taxable. H. Liebes & Co. v. Commissioner, 9 Cir., 90 F. 2d 932. Thus, in this case, if the taxpayer had sold a large number of subscriptions to its paper for the taxable year, payments for which were to be made in a subsequent taxable year, the amount would accrue and be taxable when the subscriptions were sold. An important feature of the accrual system is that income shall be reported at such a time that it will, so far as possible, be offset by expenditures incident to earning it, rather than expenditures related to earning other income. Commissioner v. Security Flour Mills, 10 Cir., 135 F. 2d 165, aff'd. 321 U. S. 281; Aluminum Castings Co. v. Routzahn, 282 U. S. 92; Niles Bement Pond Co. v. United States, 281 U. S. 357; Lucas v. Ox Fibre Brush Co., 281 U. S. 115; American National Company v. United States, 274 U. S. 99; United States v. Anderson, 269 U. S. 422.

In sustaining the Commissioner, the Tax Court applied what has become known as the "claim of right" doctrine. The Commissioner says in his brief that the doctrine is "the legal theory underlying the Tax Court's decision." This theory, as applied to taxable income, is that when a taxpayer receives funds during a taxable year under a

claim that he has the right to possession and use of the funds with no restriction as to their disposition, it is income even though the claim subsequently is found to be invalid, and the taxpayer is required to repay the funds. North American Oil Consolidated v. Burnet, 286 U. S. 417; United States v. Lewis, 340 U. S. 590; Healy v. Commissioner, 345 U. S. 278; Commissioner v. Security Flour Mills Co., supra.[1] In each of these cases the question presented was whether the ownership or claim of ownership to the funds was sufficient for them to be taxed as income to the person receiving them, and there was no issue as to when they were returnable for taxation. In the so-called "claim of right" cases, the taxpayer's accounting system was of no importance. If taxable funds are received, under the claim of right doctrine they are returnable in the year received regardless of the method of accounting employed by the taxpayer.

In the instant case, there is no dispute as to the ownership of the funds. Admittedly, they belong to the taxpayer with no restriction as to disposition. The question

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[1] In Healy v. Commissioner, supra, in referring to the "claim of right" principle the Supreme Court said:

> "The phrase 'claim of right' is a term known of old to lawyers. Its typical use has been in real property law in dealing with title by adverse possession, where the rule has been that title can be acquired by adverse possession only if the occupant claims that he has a right to be in possession as owner. The use of the term in the field of income taxation is analogous. There is a claim of right when funds are received and treated by a taxpayer as belonging to him. The fact that subsequently the claim is found to be invalid by a court does not change the fact that the claim did exist. A mistaken claim is nonetheless a claim. United States v. Lewis, 340 U. S. 590 (1951)." (Footnotes omitted.)

In North American Oil Consolidated v. Burnet, supra, the rule was succinctly stated as follows:

> "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent."

is, when shall they be taxed? The tax court, as it has in other cases, took the literal language from the context of the opinions in the foregoing cases and applied it to the prepaid income here even though there is no dispute as to the ownership of the funds.[3] It gave no consideration to the fact that the taxpayer accounts for its income under the accrual method and will not incur the expenses necessary to earn the income until following taxable years. In other words, the tax court holds that advance payments received by a taxpayer, which are subject to income tax, must be returned in the year of receipt if owned or claimed by the taxpayer, regardless of the method of accounting which has been adopted, or when the funds are actually earned. Such application of the rule limits the accrual method to that class of cases where money has been earned and the right to it has been fixed, but the receipt is delayed to a subsequent taxable period. The application of the doctrine would in most cases result in a distortion of an accrual taxpayer's true income. For instance, a construction contractor might be paid in advance for the construction of a building which would require the following year to complete, with all of the costs of construction incurred during the following year. A rancher might sell his next year's calf or lamb crop, and receive payment for it in advance, with the entire cost of production to be incurred the following year. A manufacturer might be paid in advance for articles to be made and delivered in a subsequent year. In each of these cases, if the tax court's application of the rule is carried to its logical conclusion, the prepaid receipts, because the taxpayer received them under a claim of right, would be taxable during the year in which they were received, even

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[3] South Tacoma Motor Co. v. Commissioner, 3 T. C. 411; Your Health Club, Inc. v. Commissioner, 4 T. C. 385; E. B. Elliott Co. v. Commissioner, 45 B. T. A. 82; National Airlines, Inc. v. Commissioner, 9 T. C. 159; Automobile Club of Michigan v. Commissioner, 20 T. C. 1033; and see also South Dade Farms v. Commissioner, 5 Cir., 138 F. 2d 818; Capital Warehouse Co. v. Commissioner, 8 Cir., 171 F. 2d 395; Booth Newspapers, Inc. v. Commissioner, 17 T. C. 294, affirmed, 6 Cir., 201 F. 2d 55.

though the taxpayer kept his books on an accrual basis. The right to return income on a completed contract basis would be destroyed. This would produce an incongruous result. It would permit the collection of taxes during periods not contemplated by the accrual method of accounting, and force the taxpayer into a cash receipts basis for all prepaid items. Such was not the reasoning or the purpose of the cases relied upon. Such an application of the rule requires the taxpayer to report its prepaid income on a cash basis and to accrue its deductions. It creates a hybrid bookkeeping system and results in a tax return which does not clearly reflect income. Commissioner v. South Texas Co., 333 U. S. 496, 501. To a large extent, it destroys the principle inherent in the accrual method of accounting. Plainly, Section 42 contemplates that prepaid sums can be returned in a year other than when received. It says that income shall be included in the taxable year received "unless, under methods of accounting permitted under Section 41, any such amounts are to be properly accounted for as of a different period." This is not a case where the Commissioner has exercised his broad discretion to require a taxpayer to adopt an accounting method which will clearly reflect income, but is one in which he has improperly applied a legal principle.

Congress has taken cognizance of the existing situation as to prepaid income and has sought to remedy it by statute. The 1954 Internal Revenue Code, with certain limitations, permits accrual basis taxpayers to defer the reporting of advanced payments as income until the year, or years, in which, under the taxpayer's regular method of accounting, the income is earned and to assure that items of income and deductions will be properly taken into account.[8]

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[8] The report of the Senate Finance Committee upon this section reads:

"Present law provides that the net income of a taxpayer shall be computed in accordance with the method of accounting regularly employed by the taxpayer, if such method clearly reflects the in-

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The Commissioner urges that since the taxpayer had for years prior to 1943 and 1944 carried these accounts on its books as cash items, it cannot change its system of accounting without the consent of the Commissioner. Treasury Regulations 111, Sec. 29.41-2. The Commissioner is vested with wide discretion in determining whether a change in a taxpayer's method of accounting shall be allowed. Brown v. Helvering, 291 U. S. 193; Aluminum Castings Co. v. Routzahn, supra; United States v. Anderson, supra; United States v. American Can Co., 280 U. S. 412; Niles Bement Pond Co. v. United States, supra. The taxpayer, however, did not seek to change its accounting system. It did no more than apply the method adopted and in use to clearly reflect its income. This the taxpayer had the right to do and the Commissioner had the right to require it. United States v. American Can Co., supra. A discretion of the Commissioner does not empower him to add to the taxpayer's gross income for a given year, an item which rightfully belongs in another year. Commissioner v. Frame, 8 Cir., 195 F. 2d 166; Commissioner v. Mnookin's Estate, 8 Cir., 184 F. 2d 89.

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come, and the regulations state that approved standard methods of accounting will ordinarily be regarded as clearly reflecting taxable income. Nevertheless, as a result of court decisions and ruling, there have developed many divergencies between the computation of income for tax purpose and income for business purposes as computed under generally accepted accounting principles. The areas of difference are confined almost entirely to questions of when certain types of revenue and expenses should be taken into account in arriving at net income.

"The changes embodied in the House bill and in your committee's bill are designated to bring the income-tax provisions of the law into harmony with generally accepted accounting principles, and to assure that all items of income and deductions are to be taken into account once, but only once in the computation of taxable income.

* * * * *

The House and your committee's bill permit accrual-basis taxpayers to defer the reporting of advance payments as income until the year, or years, in which, under the taxpayer's regular method of accounting, the income is earned." Report of the Committee on Finance of the United States Senate, p. 62, 1954 U. S. Code Congressional Service, p. 2691-2.

We have no doubt that the taxpayer could not change its method of keeping books without the consent of the Commissioner, even as to items, if the change resulted in an avoidance of the payment of taxes due, nor do we have any doubt but that a taxpayer may, without the consent of the Commissioner, apply the method of accounting which he has adopted, though not theretofore applied to a particular item, when that change will correct errors and clearly reflect his income. We think the change in this case falls within the latter category.

The decision of the tax court is reversed.

Bratton, Circuit Judge dissenting:

The taxpayer received the funds representing prepaid subscriptions under claim of right without any restrictions in respect to their use. The funds were placed in the capital structure of the taxpayer with no limitations or proscriptions upon their application, enjoyment, or disposition. The taxpayer was required to make refunds in case of cancellations of prepaid subscriptions, but that obligation was contingent. It depended entirely upon whether cancellations were made. Unless a subscription should be cancelled no refund would be made. It seems clear to me that under the settled law in force at the time, the entire amount received for prepaid subscriptions constituted income returnable for the year in which it was received, even though the taxpayer kept its books and made its returns on the accrual basis. Brown v. Helvering, 291 U. S. 193; South Dade Farms v. Commissioner, 138 F. (2d) 818; Clay Sewer Pipe Association v. Commissioner, 139 F. (2d) 130; Capital Warehouse Co. v. Commissioner, 171 F. (2d) 395. And therefore I would affirm the decision of the Tax Court.

E. W. Schuessler and Aline Schuessler
v. Commissioner

(U. S. Court of Appeals, Fifth Circuit, No. 15751, March 14, 1956)

Petition for Review of Decision of The Tax Court of the United States (District of Alabama).

Before Borah, Tuttle and Jones, Circuit Judges.

Tuttle, Circuit Judge:

This is a petition for review of a decision by the Tax Court disallowing a deduction in 1946 of an item of $13,300.00, representing a reserve set up by taxpayers while keeping their books on the accrual basis, to represent their estimated cost of carrying out a guarantee, given with each of the furnaces sold by them during the year, to turn the furnace on and off each year for five years.

The opinion of the Tax Court treats the matter as though ample proof was offered by the taxpayer (hereafter the husband will be called "taxpayer") to raise the legal issue and we find the record warrants this treatment. Taxpayer was in the gas furnace business in 1946, during which he sold 665 furnaces, each with a guarantee that he would turn the furnace on and off each year for five years. The fact that such service, if performed, would cost $2.00 per call was amply established. The taxpayer, himself a bookkeeper and accountant prior to entering this business, testified to his keeping his books on the accrual method and claimed that the only way his income could be accurately reported was by charging against the cost of furnaces sold in 1946 the reserve representing the amount which he became legally liable to expend in subsequent years in connection with the sales. The proof was clear that he actually sold the furnaces for $20.00 to $25.00 more than his competitors because of his guarantee, which they did not give.

We think it quite clear that petitioner's method of accounting comes much closer to giving a correct picture of

his income than would a system in which he sold equipment in one year and received an inflated price because he obligated himself, in effect, to refund part of it in services later but was required to report the total receipts as income on the high level of the sales year and take deductions on the low level of the service years. The reasonableness of taxpayer's action, however, is not the test if it runs counter to requirements of the statute.

We find that not only does it not offend any statutory requirement, but, in fact, we think it is in accord with the language and intent of the law.[1] Clearly what is sought by this statute is an accounting method that most ac-

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[1] See in this connection the following sections of the Internal Revenue Code of 1939:

Sec. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income * * *.

(26 U. S. C. A. 1952 ed., Sec. 41.)

Sec. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN

The deductions and credits * * * provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period * * *.

(26 U. S. C. A. 1952 ed., Sec. 43.)

See also Treasury Regulation 111 as follows:

Sec. 29.41-1. COMPUTATION OF NET INCOME.—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of

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curately reflects the taxpayer's income on an annual accounting basis.[2]

The decisions of the Tax Court and of the several Courts of Appeals are not uniform on this subject, some circuits requiring a mathematical certainty as to the exact amount of the future expenditures that cannot be satisfied in the usual case. Other circuits, seemingly more concerned with the underlying principle of charging to each year's income reasonably ascertainable future expenses necessary to earn or retain the income, have permitted the accrual of restricted items of future expenses. Two of this latter category are Harrold v. Commissioner[3] and Pacific Grape Products Co. v. Commissioner.[4]

In the Harrold case the taxpayer was permitted to deduct from its gross income in 1945 the estimated cost of back filling a tract of land which would be done under state law requirements in the year 1946. The Court there said:

> "* * * when all the facts have occurred which determine that the taxpayer has incurred a liability in the tax year, and neither the fact nor the amount of the liability is contested, and the amount, although not definitely ascertained, is susceptible of estimate with reasonable accuracy in the tax year, deduction thereof from income may be taken by a taxpayer on

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expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for * * *.

[2] This principle was early recognized in United States v. Anderson, 269 U. S. 422, 46 S. Ct. 131, 70 L. Ed. 347.

[3] (4 Cir.), 192 F. 2d 1002.

[4] (9 Cir.), 219 F. 2d 862.

an accrual basis." Harrold v. Cimmissioner, (4 Cir.), 192 F. 2d 1002, 1006.

The Pacific Grape Products case is also, it seems to us, indistinguishable in principle from the case before us. There the taxpayer accrued the sales price of canned goods sold on December 31, and at the same time deducted the estimated cost of labeling and preparing the goods for shipping and brokerage fees to be paid the following year. The Tax Court, with six judges dissenting, accepted the Commissioner's view that the deductions should be disallowed. The Court of Appeals reversed, saying:

> "Not only do we have here a system of accounting which for years has been adoptd and carried into effect by substantially all members of a large industry, but the system is one which appeals to us as so much in line with plain common sense that we are at a loss to understand what could have prompted the Commissioner to disapprove it. Contrary to his suggestion that petitioner's method did not reflect its true income it seems to us that the alterations demanded by the Commissioner would wholly distort that income."

The case of Beacon Publishing Co. v. Commissioner[8] is considered by both parties here and was noted by the Tax Court as of especial significance. That case involved the treatment of prepaid income received by the Beacon Publishing Co. covering subscriptions to be furnished in subsequent years. The Tax Court in its decision here said:

> "* * * This is essentially the same problem as the reporting of prepaid income in the year in which received for services to be performed in following years. The petitioner in fact, on brief, recognizes that the two problems are identical and cites Beacon Publishing Co. v. Commissioner, 218 F. 2d 697 (C. A. 10, 1955), in support of his argument that the reserve here in issue was a proper deduction in computing his income in 1946."

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[8] (10 Cir.), 218 F. 2d 697.

The Tax Court then simply declined to follow the Court in the Beacon case, preferring to adhere to its own views as expressed in Curtis A. Andrews v. Commissioner, 23 T. C. 1026. We prefer the reasoning as well as the conclusion reached by the Court in the Tenth Circuit. There the opinion correctly, we think, disposed of the "claim of right" theory advanced by the Commissioner and adopted by the Tax Court in this type of case.[6]

Finally we think the enactment in 1954 of Section 462 of the Internal Revenue Code of 1954[7] and its subsequent repeal constitute no legislative history bearing on the construction of the provisions of the Internal Revenue Code of 1939.[8]

The record below amply supports the contention of the taxpayer that there was a legal liability created in 1946, when the purchase price was paid for the gas furnaces, for the taxpayer to turn the furnaces on and off for the succeeding five years; that the cost of such service as reasonably established at a minimum of $2.00 per visit; and that the payment of $20.00 to $25.00 extra by the purchasers fully proved their intention to call upon the taxpayer each year for the service. These facts authorized the setting up of a reserve out of the 1946 income to enable the taxpayer to meet these established charges in future years. The decision of the Tax Court is therefore in error and must be reversed.

REVERSED with directions to enter judgment for the taxpayer.

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[6] See Beacon Publishing Co. v. C. I. R., 218 F. 2d 697, 699.

[7] 26 U. S. C. A. §462.

[8] For an interesting discussion of the history of this legislation see Sen. Rep. No. 372, 84 Cong., 1st Sess. (1955 U. S. Code Congressional and Administrative News, pp. 2314-2319). See also Sporrer, The Past and Future of Deferring Income and Reserving for Expenses, TAXES (Mag.) January 1956, 45.